PENN CENTRAL

1967 ANNUAL REPORT

This Annual Report *combines the 1967 consolidated results of the two companies which are now Penn Central, and shows comparable figures for 1966. A supplement containing additional statistics and financial data, is available upon request from the Secretary, Penn Central, Six Penn Center, Philadelphia, Pa. 19104.*

The Interpretive Photographs *by Seymour Mednick, depict the service of the Penn Central railroad system to some of its major markets—steel, coal, chemical and forest products, the automobile industry, and the food industry.*

The Illustrated Map *relates the railroad system to the principal subsidiary companies, and the prismatic montage symbolizes the growing diversification of Penn Central.*

The Annual Meeting *of stockholders will be held in the Philadelphia Civic Center, Civic Center Boulevard at 34th Street, Philadelphia, Pa., at 2 p.m., Tuesday, May 7, 1968.*

Stock Transfer Offices—*1808 Transportation Center, Six Penn Center Plaza, Philadelphia, Pa. 19104; Room 1010, 466 Lexington Avenue, New York, N.Y. 10017; The First National Bank of Boston, 45 Milk Street, Boston, Mass. 02109; Continental Illinois National Bank & Trust Company of Chicago, 231 South LaSalle Street, Chicago, Ill. 60604.*

PENNSYLVANIA NEW YORK CENTRAL TRANSPORTATION COMPANY | 121st ANNUAL REPORT

Contents

Alfred E. Perlman   Stuart T. Saunders

LETTER TO THE STOCKHOLDERS

Consummation of the Penn Central merger on February 1, 1968, began an exciting new chapter in the annals of American business. Our merger created the largest transportation company and one of the largest industrial corporations in the nation.

As a diversified company, we are broadening our base of earning capacity in order to achieve a more satisfactory rate of return on investment for our stockholders and to provide greater security and job opportunity for our employes. In addition to railroads, we are involved in ownership, development and management of real estate and in operation of petroleum pipelines.

We will continue to emphasize this diversification program which is making a growing contribution to consolidated earnings.

As a transportation system, we are modernizing our properties and making technological advances which will improve our service and efficiency.

Although we are just getting started, the transition and progress of our merger has been smoother and more rapid than we had anticipated. Sound and comprehensive planning while we awaited consummation enabled us to evolve a close working relationship between the two companies.

A remarkable spirit of cooperation and enthusiasm is manifest throughout our new organization. We are confident that we have a talented, experienced and well-qualified management team for the years ahead, and we consider this a very important asset.

One of the great strengths of Penn Central lies in the fact that we are uncommitted to traditional approaches. We are adopting the best practices and procedures of each of the former companies.

We start with a foundation of solid achievement on which to build. Since 1961, Penn Central has had the largest capital expenditure program in the railroad industry for acquiring new freight cars and locomotives and upgrading facilities.

Penn Central is in the forefront of the rail industry in adapting computer technology to virtually every phase of the railroad business. We will stress innovation in transportation techniques, marketing concepts and scientific research.

We are a vigorous force in the industrial development of the territory we serve. Last year alone nearly 750 new plants and plant expansions were located on our lines.

We are doing more than any other railroad to develop a new role for passenger traffic, concentrating on intermediate-range service in densely populated areas. The high-speed service between Washington and New York which we are developing in cooperation with the Federal Department of Transportation is the largest and most unique marketing project in railroad history.

We are working with governmental authorities to increase public support for suburban passenger service in the New York and Philadelphia metropolitan areas. With such continued cooperation, we hope both to modernize equipment completely and to curtail the chronic deficits from this source.

Penn Central is cultivating the profit potential of properties and air rights over railroad facilities in the major cities we serve. Among these properties are Madison Square Garden and the Penn Plaza office building over the newly renovated Penn Station, office buildings, and hotels in the Grand Central area of New York City; Penn Center and 87 acres of yards adjacent to 30th Street Station in Philadelphia; the 148-acre Penn Central Park in Pittsburgh; and the Gateway Center office complex at Union Station in Chicago. In Washington, we are completing arrangements to lease Union Station to the National Park Service for conversion into a Visitors Center.

Penn Central's consolidated earnings for 1967 of $71.4 million (before extraordinary charges) reflect a growing contribution to profits by non-railroad subsidiaries, but a sharp decline in railroad net income. It was a poor year for the entire railroad industry, and particularly those in the East.

Our railroad operating revenues fell from $1.7 billion in the previous year to $1.6 billion in 1967, a decline of 4.5 per cent. Payroll and fringe benefit costs rose at a $60 million annual rate during 1967, far more than could be recovered by the inadequate increase in freight rates which became effective on August 19. Earnings were also adversely affected by strikes in the automobile, copper, shipping and railroad industries and by the general slowdown in the nation's economy.

The reserves (described on page 30) which the Interstate Commerce Commission has authorized allow for certain extraordinary costs of the merger which are not assignable to operations of 1968 and years thereafter. This procedure assures that the earning capacity of the merged company will be accurately reflected by its financial results in the future.

Penn Central's financial results for 1968 will depend, of course, on the level of business generally. Present projections indicate that the current year should show substantial improvement over 1967. We are hopeful that there will be a marked upturn in railroad income and a continued increase in earnings from other sources.

We look forward to our first year of merged operations with confidence and enthusiasm.

Sincerely,

Stuart T. Saunders

March 15, 1968

Stuart T. Saunders,
Chairman of the Board

Alfred E. Perlman

Alfred E. Perlman,
President

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DIRECTORS

1 Stuart T. Saunders .... *Chairman of the Board, Penn Central, Philadelphia*
2 Alfred E. Perlman .... *President, Penn Central, New York*
3 Walter H. Annenberg .... *President, Triangle Publications, Inc., Philadelphia*
4 Howard Butcher, III .... *Partner, Butcher & Sherrerd, Philadelphia*
5 William L. Day .... *Chairman of the Board, The First Pennsylvania Banking and Trust Co., Philadelphia*
6 Otto N. Frenzel .... *Chairman of the Board, Merchants National Bank and Trust Co., Indianapolis*
7 R. Walter Graham, Jr., M.D. . . *Management of Personal Investments, Baltimore*
8 Isaac B. Grainger .... *Member of Advisory Committee to the Board of Directors and Retired President of Chemical Bank New York Trust Company, New York*
9 Edward J. Hanley .... *Chairman of the Board, Allegheny Ludlum Steel Corp., Pittsburgh*
10 Gaylord P. Harnwell .... *President, University of Pennsylvania, Philadelphia*
11 James S. Hunt .... *Chairman of the Board, Coral Ridge Properties, Inc., Coral Springs*
12 Fred M. Kirby .... *Chairman of the Board, Alleghany Corporation, New York*
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15 Richard K. Mellon .... *President and Governor, T. Mellon & Sons, Pittsburgh*
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17 Thomas L. Perkins .... *Counsel, Perkins, Daniels & McCormack, New York*
18 William G. Rabe .... *Vice Chairman of the Board, Bank of Palm Beach & Trust Co., Palm Beach*
19 R. Stewart Rauch, Jr. .... *President, The Philadelphia Saving Fund Society, Philadelphia*
20 R. G. Rincliffe .... *Chairman of the Board, Philadelphia Electric Company, Philadelphia*
21 Carlos J. Routh .... *President, Pittston Company, New York*
22 John M. Seabrook .... *President, International Utilities Corporation, Philadelphia*
23 James M. Symes .... *Chairman of the Executive Committee, Penn Central, Philadelphia*
24 Daniel E. Taylor .... *Management of Personal Affairs, West Palm Beach*
25 Joseph H. Thompson .... *Director, Hanna Mining Company, Cleveland*

SYSTEM OFFICERS

Stuart T. Saunders ..... *Chairman of the Board*
Alfred E. Perlman ..... *President*
David C. Bevan .... *Chairman of the Finance Committee*
Walter R. Grant .... *Executive Vice President*
David E. Smucker ...... *Executive Vice President*
Henry W. Large .... *Executive Vice President*
Robert W. Minor ...... *Senior Vice President*
Guy W. Knight .... *Senior Vice President*
John E. Chubb .... *Vice President—Baltimore*
Basil Cole .... *Vice President —Executive Department*
William S. Cook .... *Vice President and Comptroller*
Leo B. Fee .... *Vice President —Employe Relations*
Robert G. Flannery .... *Vice President —Systems Development*
Paul D. Fox .... *Vice President —Administration*
A. Paul Funkhouser .... *Vice President Coal and Ore Traffic*
William R. Gerstnecker. . *Vice President—Corporate*
Robert Haslett .... *Vice President—Investments*
Samuel H. Hellenbrand. . *Vice President—Industrial Development & Real Estate*
J Benton Jones .... *Vice President*
Fred L. Kattau .... *Vice President—Management Planning & Development*
John C. Kenefick ...... *Vice President —Transportation*
William F. Kirk .... *Vice President —Mail, Express & Highway Services*
William A. Lashley ..... *Vice President—Public Relations & Advertising*
John G. Patten .... *Vice President—Freight Sales*
John B. Prizer .... *Vice President and General Counsel*
Malcolm P. Richards ... *Vice President —Purchases and Materials*
James R. Sullivan ..... *Vice President—Marketing*
George C. Vaughan .... *Vice President— Engineering & Equipment*
Theodore K. Warner, Jr. . . *Vice President—Taxes*
James J. Wright .... *Vice President—Research*
Bayard H. Roberts ..... *Secretary*
Raymond C. McCron ... *Treasurer*

OFFICERS OF MAJOR SUBSIDIARIES

George S. Patterson ..... *President, Buckeye Pipe Line Company, New York*
Angus G. Wynne, Jr. .... *President, Great Southwest Corporation, Arlington, Texas*
Brown L. Whatley ...... *President, Arvida Corporation, Miami*
William C. Baker .... *President, Macco Realty Company, Newport Beach, California*
Solomon Katz .... *President, Strick Corporation, Fairless Hills, Pennsylvania*
Curtis D. Buford .... *President, The Pittsburgh and Lake Erie Railroad Company, Pittsburgh*
Charles L. Towle .... *President and Chairman of the Board, Detroit, Toledo and Ironton Railroad Company, Dearborn, Michigan*
John F. Nash .... *President and General Manager, Lehigh Valley Railroad Company, Bethlehem, Pa.*

Railroads, pipelines, real estate development—these are facets of the diversified Penn Central.

FINANCIAL HIGHLIGHTS OF THE PENN CENTRAL CONSOLIDATED SYSTEM

See notes to financial statements, pages 29, 30 and 32

		1967	1966
From the Earnings Statement	Total income—all sources	$2,074,276,902	$2,042,438,783
	Depreciation, amortization and depletion	$ 137,949,859	$ 133,171,891
	Interest and debt expense	$ 94,509,037	$ 86,976,706
	Federal Income Taxes	$ 4,077,667	$ 7,157,887
	Earnings from ordinary operations	$ 71,433,340	$ 147,289,578
From the Balance Sheet	Working capital (before debt due in one year)	$ 90,596,046	$ 157,143,742
	Total Assets	$6,264,315,937	$6,319,795,455
	Long term debt—due in one year	$ 120,645,169	$ 129,059,347
	—due after one year	$2,007,946,045	$1,993,142,619
	Shareholders' equity	$2,895,757,031	$3,151,380,141
	Number of shares outstanding*	23,016,274	22,883,868
Per Share of Penn Central Stock	Based on shares outstanding at close of respective years*		
	Earnings from ordinary operations	$3.10	$6.44
	Dividends	$2.40	$2.35
	All taxes	$6.62	$6.09

**After giving effect to exchange of The New York Central Railroad Company stock*

FINANCIAL REVIEW

Penn Central on a consolidated basis earned $71.4 million in 1967 before deduction of the extraordinary charge to set up a reserve covering some of the expenses of putting our merger into effect.

On the basis of 23,016,274 Penn Central shares of stock outstanding at the close of the year, consolidated earnings per share in 1967 (before extraordinary charges) were $3.10. The comparable figure in 1966 was $6.44.

In 1967, Penn Central had consolidated revenues of $2.07 billion, an increase of 1.6 per cent over the $2.04 billion of 1966.

Consolidated net earnings of the Pennsylvania Company, an investment holding corporation which is a wholly owned subsidiary of Penn Central, amounted to approximately $61.6 million last year, a rise of 3.7 per cent over 1966 earnings of $59.4 million. After providing for debt service and dividends on preferred stock, the Pennsylvania Company paid $25.5 million in dividends to Penn Central in 1967. This was a rise of $1.5 million over 1966.

Our return from diversified holdings of Pennsylvania Company increased substantially. Buckeye Pipe Line Company and our real estate development companies —Macco, Great Southwest and Arvida—contributed $22 million to our 1967 net, an increase of 34 per cent over the comparable figure for the previous year. Each of these subsidiary companies increased its earnings in 1967, and we expect additional gains in 1968.

Pennsylvania Company also holds our investment in the Norfolk & Western Railway Company and the Wabash Railroad which is now leased to the N&W system. Divestiture of these holdings, as required by the Interstate Commerce Commission over a ten-year period, began in 1964. Under an agreement with the N&W to exchange 800,000 shares of N&W common stock for 4⅝ per cent N&W convertible subordinated debentures with par value of $104 million in ten equal installments, we had exchanged 240,000 shares in three installments by the end of 1967.

In January another 80,000 shares were exchanged, bringing the total to 320,000. Of the $41.6 million in debentures received for the stock, $26.5 million have been sold.

In 1967, Penn Central stockholders received approximately $55.1 million in dividends. Regular quarterly dividends of 60¢ a share were maintained by the Pennsylvania for a total of $2.40 per share. The Central's dividends totalled $3.12 for the year, or 78¢ each quarter.

Railroad earnings reacted very unfavorably to the leveling off of the economy and a steep rise in wage, fringe benefit and supply costs. These factors combined to reduce our consolidated earnings from ordinary operations to less than half of the $147.3 million accounted for by the Penn Central companies on a comparable basis in 1966.

Our overall costs of doing business increased during the year to approximately $2 billion as compared with $1.9 billion in the previous year. In addition to higher costs, the railroad also suffered revenue losses from labor difficulties in the automobile, maritime, railroad and copper industries.

The consolidated company provided for capital improvements amounting to $360 million in 1967.

In accordance with generally accepted accounting principles, we have established special reserves totalling approximately $275 million to provide both for losses on certain facilities and inventories made obsolete or surplus by the merger, and for costs incurred under labor agreements that require recall of some previously furloughed employes who are surplus to our present requirements. When the designated facilities or inventories are removed from service and scrapped, and as we pay these employes, the related costs and losses will be charged against the reserves.

REAL ESTATE

Gross receipts from all Penn Central real estate operations and sales, both of railroad-related properties and subsidiary companies, totalled $205.5 million in 1967, an increase of nearly 50 per cent over the 1966 figure of $137.3 million.

The rebuilding of Pennsylvania Station in New York, the new Madison Square Garden Center and the 29-story Penn Plaza office building was completed in February, 1968. We have a 25 per cent interest in the Garden Center and a 55 per cent interest in the office building, which is entirely leased.

Air rights over Grand Central Terminal have been leased for construction of a 2-million-square-foot office building. The Grand Central Terminal-area properties produced $18,468,000 last year. A 41-story addition to the recently completed 280 Park Avenue building was begun over railroad and adjoining property. Two new skyscrapers—the American Tobacco Building and the Westvaco Building—were completed on Penn Central's Park Avenue properties. Realty Hotels assumed management of the Commodore Hotel in June, 1967, and has expedited a million-dollar renovation program.

In Philadelphia, we sold the last available parcels of the Penn Center development. Construction of the tenth new building in this area has just started. We are now making long-range plans for the development of 87 acres of air rights and other property near Pennsylvania Station-30th Street in Philadelphia.

In Pittsburgh, expressways are being designed and parcels of property are being acquired for the 148-acre Penn Central Park redevelopment project. Rail trackage is being relocated and construction of new office, commercial, and parking structures is expected to begin late in 1968.

Madison Square Garden complex over Penn Station in New York typifies intensive development of urban properties.

In Washington, the Union Station property owned jointly by Penn Central and the Baltimore & Ohio Railroad is to be converted into a National Visitors Center and leased to the National Park Service. A 4,000-car parking garage will be built over yard air rights, and the interior of the station will be remodeled to accommodate an auditorium, theaters, exhibit rooms, reception areas and other tourist facilities. A new railroad passenger station will be built under the parking garage.

At Chicago's Gateway Center over Union Station, in which we have a 50 per cent interest, the second of two new office buildings is being completed by a tenant and a third is contemplated. Arrangements are being negotiated for moving former New York Central operations from LaSalle Street Station into combined facilities at Union Station.

On-Line Plant Location—Our industrial development specialists assisted in the location and expansion of 740 manufacturing plants on Penn Central lines during 1967. These facilities have a potential of approximately 321,000 carloads of freight on an annual basis.

At the end of 1967, we had on our system 178 privately owned industrial parks and districts covering 32,457 acres. During the year, 67 parks with a total of 8,500 acres were established.

Since the merger, Penn Central has stepped up industrial development activities to take advantage of its greater number of plant sites and the improved service it can offer to industries.

Macco Realty Company—The common stock of Macco Realty Company, which has a very large and attractive inventory of land available for development in Southern California, is wholly owned by the Penn Central. Although in the last year that area has gone through its lowest level of housing starts since World War II, Macco is performing creditably under extremely adverse marketing conditions. Its 1967 earnings amounted to $7,566,000, compared with $4,330,000 in 1966, an increase of 75 per cent.

Great Southwest Corporation—Great Southwest Corporation, 80 per cent owned by Penn Central, is a land company in the Dallas-Ft. Worth area of Texas and in Atlanta, Georgia. Its 1967 earnings rose to $5,014,000, an increase of 67 per cent from $3,007,000 in 1966.

Great Southwest Corporation's industrial sales and lease revenues set new records in 1967, with land sales and leases in four industrial parks comprising more than 6,000 acres in the metropolitan Dallas-Ft. Worth area and with the opening of a 3,000-acre industrial park in Atlanta.

Great Southwest also operates "Six Flags Over Texas" and "Six Flags Over Georgia," historical-theme family amusement parks. The Texas park set an attendance record of more than 2 million guests during 1967, its seventh year of operation. "Six Flags Over Georgia" opened in June, 1967, and attracted 1,100,000 visitors in its first summer of operation.

Arvida Corporation—Arvida Corporation, in which Penn Central has a 59 per cent interest, is developing more than 40,000 acres of real estate on the Atlantic and Gulf Coasts of Florida. Earnings from its resort, residential, commercial and industrial properties in the Miami, Fort Lauderdale, Boca Raton, Palm Beach and Sarasota areas continued to rise in 1967. Net income of $1,060,000 was an increase of 4 per cent over 1966 earnings of $1,022,000.

Tower at Boca Raton Hotel and Club is part of $13 million expansion program.

Major sales by Arvida in 1967 included a 25,000-acre tract in Dade County to Aerojet-General Corporation for a solid fuel rocket assembly and test center.

Arvida's world-famous Boca Raton Hotel and Club is undergoing a $13-million modernization and expansion program that will double its facilities for conventions and conferences, as well as resort patronage.

PIPELINE OPERATIONS

Buckeye Pipe Line Company, whose common stock is wholly owned by Penn Central, operates a 7,500-mile network of pipelines for transporting crude oil to refineries and refined products to consuming areas in seven states in the Northeast and Midwest. In addition, the company operates pipelines in the states of Florida and Washington.

Buckeye's 1967 earnings reached a record of $13,604,000, before provision of $324,000 for dividends on its newly issued preferred stock. This is an increase of 9.5 per cent over the $12,425,000 in 1966. The network transported 13 billion gallons of petroleum, averaging 434,000 barrels of refined products and 440,000 barrels of crude oil a day.

With completion of its Long Island branch in June, Buckeye became the principal jet fuel supplier for Kennedy International Airport. The company's refined products system in Ohio, Michigan and Pennsylvania is being modernized and expanded.

At a cost of $17 million, Buckeye in 1967 tripled its capacity for delivering Canadian crude oil to Detroit and Toledo refineries, and completed the first phase of a construction program that will double its capacity for delivering refined products in Eastern Pennsylvania and upper New York State.

During the year, the company's international pipeline affiliate, Europipe S.A., prepared feasibility studies for pipeline projects in the Common Market countries and South America. Buckeye is associated with British, French and German interests in this venture.

TRAILER AND CONTAINER MANUFACTURING

Strick Corporation, a wholly owned subsidiary of Penn Central, is a pioneer in the manufacturing of aluminum trailer and container equipment. Strick's net income for 1967 totalled $861,000 on revenues of $69.3 million. A strike of two months disrupted production and severely reduced earnings.

RAILROAD OPERATIONS

For Penn Central, as well as the entire railroad industry, 1967 was a disappointing year. The downturn in the national economy brought on a decline in traffic volume which erased the favorable leverage of 1966. The upward spiral of labor contracts, together with strikes in several basic industries, added to the adverse pressures on earnings.

Penn Central's railroad operating revenues in 1967 declined to $1.6 billion from approximately $1.7 billion in 1966. Freight revenues dropped 2.9 per cent to approximately $1.3 billion, and passenger revenues fell 11.4 per cent to $115 million, their lowest level since 1940. Mail revenues were reduced by $8.5 million in 1967 to a level of approximately $76 million for the year—a 10.1 per cent loss largely caused by a change in distribution methods by the United States Post Office Department.

Return on investment from our railroad properties was only .8 of one per cent in 1967, compared with 2.7 per cent in 1966, demonstrating how our railroad profitability is strongly affected by swings in the national economy and increased operating costs.

Merchandise Traffic—Revenue from piggyback and containerized traffic continued to rise in 1967, and the volume of loaded trailers carried reached approximately 415,000, some 25,000 more than last year's total.

Penn Central is handling about 21 per cent of total piggyback shipments, and approximately 20 per cent of the nation's automobile output. Despite the automobile strikes in the fall, we transported more than 1.7 million new cars and trucks.

Containerization of exports and imports is one of the newest and fastest-growing types of freight service, and Penn Central greatly expanded its capability for handling rail-ship containers in 1967.

We foresee the movement of trainloads of containers in export-import traffic, not only over our own system but across the entire country, as a result of the integration of containerized inland rail traffic with steamship service.

We have made interchange agreements with 30 of the principal steamship lines offering container service to and from all parts of the world. We now have shipping agents in 10 major European cities, and we expect to increase our international container traffic in 1968.

Penn Central is making similar advances in handling other high-rated traffic. Our objective is to develop solid trainloads of manufactured goods and packaged foodstuffs operating between the East and West Coasts on through schedules. We have already initiated through freight runs with several Midwestern railroads which interchange with Western lines.

Coal and Ore Traffic—Coal continued to be the single most important source of traffic for the Penn Central, bringing about $204 million in revenues, or 16 per cent of our total freight revenues in 1967. Our railroad carried approximately 103 million tons of coal and originated shipment of about 49 million tons.

We are operating 730 unit trains a month, most of which carry coal, a steady increase over the 125 trains a month operated in 1963, when Penn Central pioneered this service.

Penn Central is moving over 10 million tons annually in unit trains with coal cars owned by utilities and other large-volume consumers.

Long-term coal contracts between the mining and electric power companies, together with volume rail rates, have led to the development of additional coal properties and rail facilities to serve them.

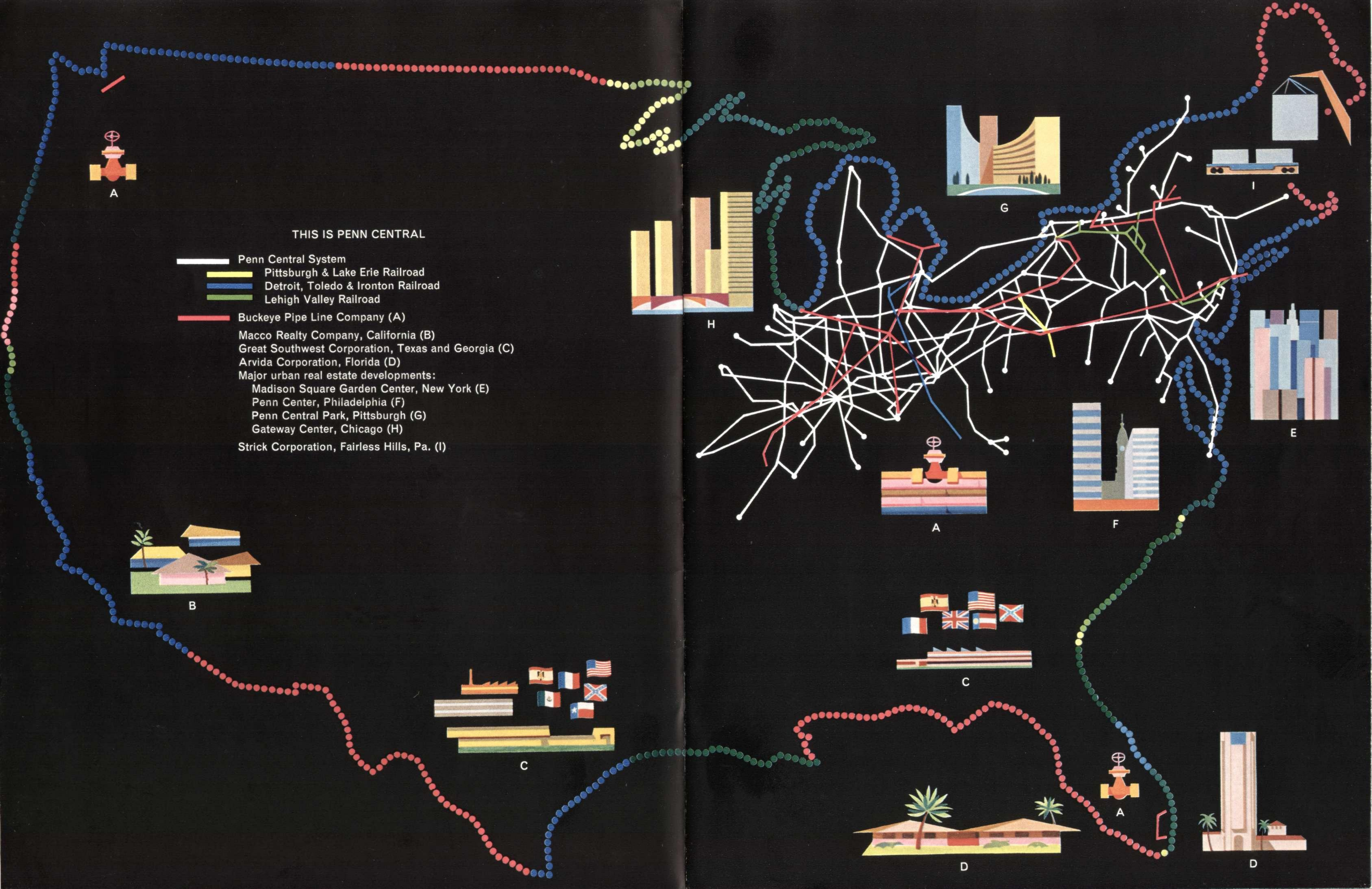
Three large construction projects designed to increase coal traffic from mines in Pennsylvania, West Virginia and Ohio are nearing completion. They represent investments of more than $75 million by the Penn Central and coal companies concerned. The bulk of the coal involved already has been sold to utilities under long-term contracts.

Penn Central's new $11.5-million automated coal pier at Ashtabula, Ohio, began operation this spring. Its million-ton ground storage capacity permits the movement of coal to Ashtabula during the winter months.

The Waynesburg Southern Railroad, a $20-million, 35-mile line extending south from Waynesburg, Pennsylvania, will be completed early this summer. It will provide access to coal reserves in excess of half a billion tons in northern West Virginia and southwestern Pennsylvania.

Our company is building a 10-mile westward extension of our Captina branch in southeastern Ohio to tap another 200 million tons of undeveloped coal reserves in that area by April, 1969.

In 1967 we handled 25 million tons of iron ore. We anticipate this traffic should increase slightly this year to approximately 26 million tons.


THIS IS PENN CENTRAL
Penn Central System
Pittsburgh & Lake Erie Railroad
Detroit, Toledo & Ironton Railroad
Lehigh Valley Railroad
Buckeye Pipe Line Company (A)
Macco Realty Company, California (B)
Great Southwest Corporation, Texas and Georgia (C)
Arvida Corporation, Florida (D)
Major urban real estate developments:
Madison Square Garden Center, New York (E)
Penn Center, Philadelphia (F)
Penn Central Park, Pittsburgh (G)
Gateway Center, Chicago (H)
Strick Corporation, Fairless Hills, Pa. (I)

Grain Traffic—Penn Central transported approximately 13.5 million tons of grain and grain products during 1967. We expect to carry a greater tonnage in 1968 as we restructure rates to compete with other methods of transportation. The merged system connects a broad grain-producing area with the leading Eastern ports and markets. We are emphasizing the use of high-capacity covered hopper cars and improved service to grain elevators and grain processing plants to build this important source of traffic.

Rates—An increase in freight rates and charges granted by the Interstate Commerce Commission on substantially all traffic, averaging 3 to 3½ per cent, became effective on August 19. For Penn Central, this amounts to approximately $42 million on an annual basis, far too little to recover higher costs of providing service.

The ICC decision granting a larger share of joint rates to Eastern railroads on traffic moving between the North and the South was reversed by a Federal Court at New Orleans, Louisiana, in a suit brought by the Southern lines. The Commission's order remains in effect, subject to a refund arrangement, pending decision on the Eastern lines' appeal to the Supreme Court of the United States.

Passenger Service—Penn Central is promoting a new role for rail passenger service in the future transportation system of an urbanized America. It is based on the concept that commuter and limited intercity rail passenger systems are a public service which must have public support. It will concentrate on development of improved equipment and facilities for commuters in metropolitan areas and the introduction of high-speed, luxury, intercity travel over intermediate distances.

Concurrently, we are undertaking a far-reaching program for adjusting our present service to actual public needs. We will proceed to phase out long-haul passenger runs and other service which the public has demonstrated it neither wants nor needs. During the past year, the Twentieth Century Limited between New York and Chicago was discontinued and two other trains between these cities, the Broadway Limited and The General, were combined.

Our passenger deficit in 1967 rose to $85 million, up 38 per cent above the $61.4 million of 1966. A decline in passenger volume, mounting wage and benefit costs, and curtailment of mail shipments contributed to this loss. Passenger revenues in 1967 dropped 11.4 per cent, to $115 million.

High-Speed Project—Penn Central's 226-mile main line between New York and Washington has been upgraded into the best roadway in the world in preparation for high-speed passenger service. Welded rail, new ties and ballast, high-level station platforms, stronger catenary wire and other improvements have been made. Inauguration of the service awaits delivery and acceptance of a fleet of 50 self-propelled Metroliner passenger cars being built by the Budd Company.

Penn Central is investing $45 million and the United States Department of Transportation $11 million in this demonstration project to test public acceptance of an entirely new type of rail travel.

The Metroliner fleet will cost more than $21 million and emphasizes speed, convenience, safety and luxury. The cars are highly complicated vehicles, far advanced in design and much more powerful than any passenger equipment previously built in this country.

To encourage rail travel, the Department of Transportation is planning two "park and ride" suburban stations—one near Lanham, Maryland, where our line passes under the Washington Beltway, and another in northern New Jersey, where the Garden State Parkway crosses under the Penn Central tracks near Iselin.

Metroliners for high-speed passenger service will offer ultimate in luxury and comfort.

About 4,000 employes—particularly trainmen, enginemen and station and equipment maintenance employes—are being trained in the technical aspects of the new high-speed service and equipment and in customer relations. On-the-job training, paid for partially by Federal funds, will continue throughout 1968.

Commuter Service—Growing acceptance of public assistance plans in Pennsylvania, New Jersey, New York and Connecticut is enabling Penn Central to modernize its commuter service in the New York and Philadelphia metropolitan areas. Operating contracts with city, regional and state authorities are cutting our deficits and public financing is expediting the acquisition of new equipment.

The City of Philadelphia purchased 20 new multiple-unit (MU) electric cars in 1967, which are leased to Penn Central. This gives us a total of 64 modern Silverliners in the Philadelphia area.

New Jersey has ordered 35 cars for delivery in 1968, to be operated by Penn Central under contract. Further orders now planned would completely reequip the northern New Jersey suburban fleet.

The State has authorized a capital improvements program for the New York and Long Branch Railroad, a 50 per cent-owned subsidiary, providing for 38 new MU cars, additional electrification, new stations with high-level platforms and elimination of grade crossings.

Under the "Aldene Plan," which went into effect April 30, 1967, Central Railroad of New Jersey trains now operate into Penn Central Station, Newark. They connect with Port Authority Trans-Hudson Corporation (PATH) service to Hudson Terminal in downtown New York and to Penn Station in mid-city.

Commuter travel in the New York City-Westchester areas continued to increase in 1967, as it did during 1966. The extension of zone scheduling permitted us to make better use of our suburban fleet in handling the increased business.

Two-way radios were installed in 33 suburban locomotives, and public address systems were placed in seven of the larger stations to provide train information for our commuters.

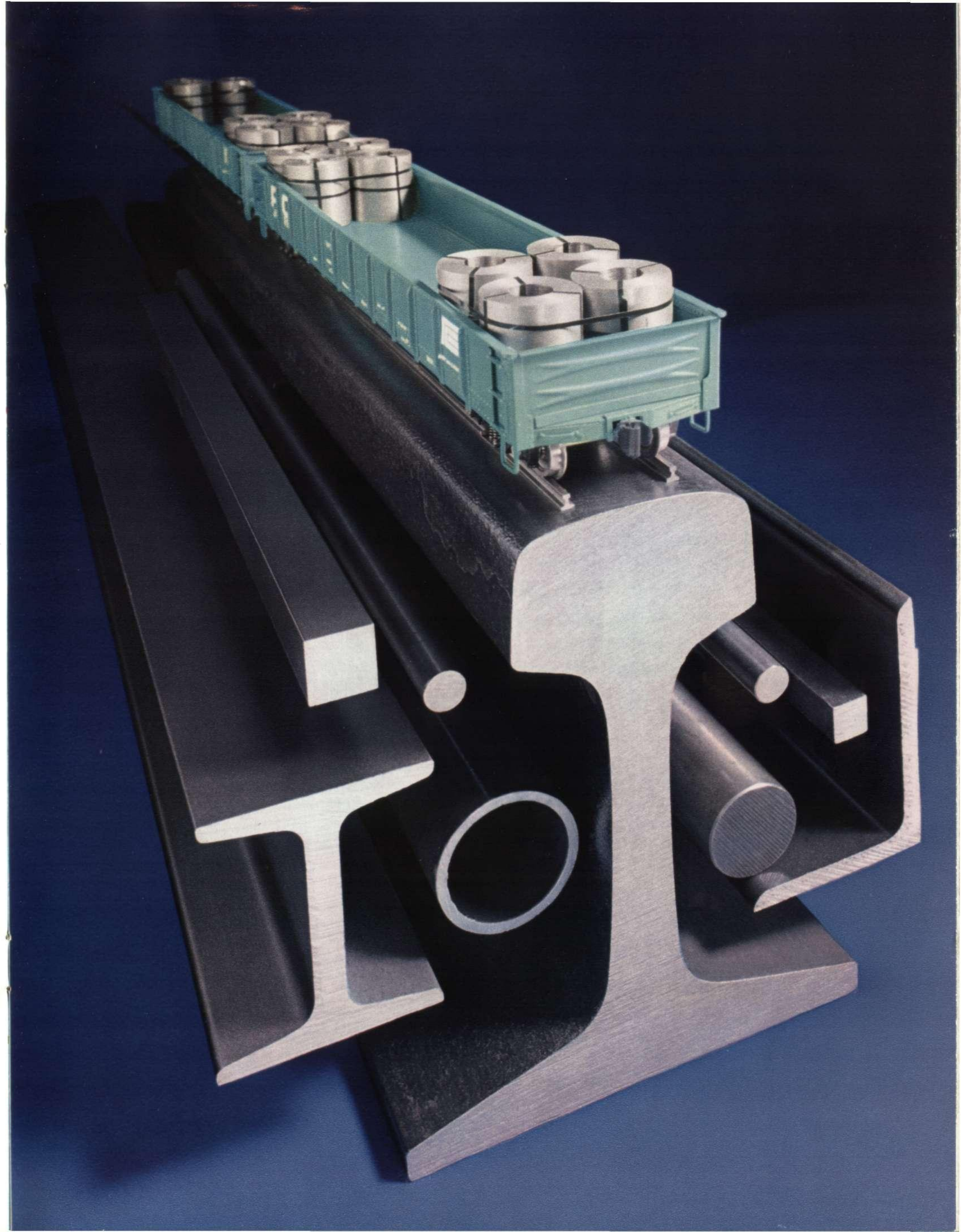
Government support of a 2½-year suburban demonstration project north of New York City between White Plains and Brewster ended in April, 1967. It added 26 weekday non-rush hour trains to attract off-peak ridership. This new service increased such business 60 per cent in three years and is being continued.

Capital Improvements—In 1967, the Penn Central railroad system, including subsidiary lines, invested $280 million in capital improvements, including $52 million for leased equipment. Since 1961, we have acquired more than $1 billion, 402 million of new equipment and facilities, primarily new freight cars and more powerful locomotives. Our fleet today is in the best condition it has been since World War II.

We acquired 180 high-powered diesel locomotives and 3,242 new freight cars in 1967. A total of 6,362 freight cars was rebuilt.

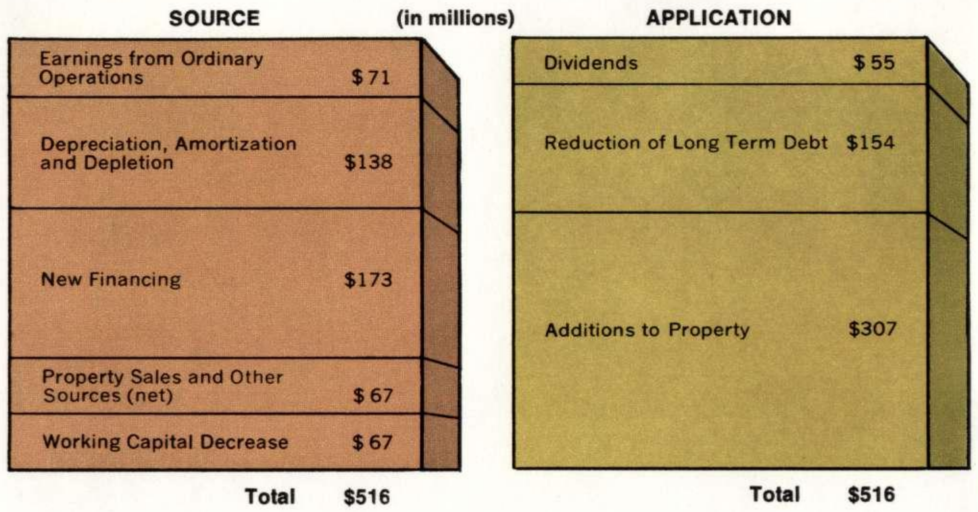
A new $29-million electronic freight classification yard at Selkirk, N.Y., is scheduled to open July 1, 1968. This 70-track facility can be expanded to a 90-track yard as traffic increases.

Technical Research—Penn Central's Technical Research Center at Cleveland, now in its 11th year, is continuing the largest research effort by any railroad. The Center's scientists and technicians undertake both basic and applied studies in their quest for innovative equipment and techniques.



Iron and steel are the second largest revenue producer for railroad operations of Penn Central.

Penn Central Consolidated Source & Application of Funds, 1967



In 1967, the Center developed a megawatt-hour indicator that gives accurate measurement of power output and efficiency of locomotives and a "power interrogator" which helps to determine proper utilization and scheduling of locomotives.

An ultrasonic listening device has been developed to detect malfunctioning machine and engine parts, as well as gas, fluid and vacuum leaks.

The Research Center is finding constructive uses for some 21 million tons of fly ash accumulated annually. These include improved methods of treating industrial sewage and the use of fly ash as a filler for certain rigid or semi-rigid plastic binders. Potential uses for such a chemical aggregate include grouting for track ballast, a resilient flooring material and a wear-resistant building material.

Information Systems Development—Synthesis of the Pennsylvania and New York Central computer systems is well under way. Virtually all departments of our company are benefitting from these advanced electronic data collection and processing systems, and we have hardly begun to capitalize on their potentialities.

During the year, Penn Central, both on its own initiative and in cooperation with the Association of American Railroads, conducted extensive field tests for automatic car identification (electronic scanning and reporting of car numbers). In October, the AAR adopted an ACI system for industry-wide use. When installed nationwide, the system will enable railroads to locate instantly any freight car in the country and should increase car utilization by as much as 10 per cent, or the equivalent of 180,000 new cars.

Since March 1967, we have been weighing road coal trains electronically in central Pennsylvania. This installation combines weigh-in-motion scales and an automatic car identification system with a computer which calculates net weights and types billing manifests almost instantaneously.

The Pittsburgh & Lake Erie Railroad Company—The Pittsburgh & Lake Erie Railroad, in which the Penn Central has an 81 per cent interest, reported 1967 net income of $9,854,000. This compared with restated earnings of $12,363,000 for 1966.

The business decline in the industries served by the P&LE in the Pittsburgh-Youngstown area led to a 6.7 per cent drop in carloadings.

Detroit, Toledo & Ironton Railroad Company—The DT&I, a wholly owned subsidiary of the Penn Central serving industrial Ohio and Michigan, earned $998,000 in 1967, a decrease of 71 per cent from 1966. The strike at Ford Motor Company and the Detroit riot had extremely adverse effects on DT&I earnings. Renovation of the Flat Rock Yard, scheduled for completion in 1968, should give better service and increase traffic volume.

PERSONNEL

At its first meeting on February 1, 1968, the Board of Directors authorized a new organizational structure for Penn Central. The Chairman of the Board is chief executive officer and the President is chief administrative officer. The Chairman of the Finance Committee is chief financial officer. Other top officers are three Executive Vice Presidents with responsibilities for the respective major areas of operations, traffic and internal financial controls; two Senior Vice Presidents, one in charge of governmental relations and the other of labor relations and personnel; and 22 Vice Presidents. These officers and their assignments are listed on page 5 of this report.

Recruiting and management training programs, very successful in 1967, will be expanded in 1968. In addition to the college graduates now working as trainees, we have increased job-improvement opportunities for many types of employment.

The Penn Central's tuition aid plan, which was established in 1964, provides up to $300 a year for employes who wish to take job-oriented courses at accredited colleges, universities and technical institutions during off-duty hours. Some 900 employes have participated in the program, nearly half in the 1966-67 school year alone.

Penn Central railroad employment averaged 106,500 last year, compared with 111,400 in 1966. Average compensation for 1967, including fringe benefits, was $9,421.

THE EASTERN MERGER PICTURE

The Interstate Commerce Commission requires, as conditions for the Penn Central merger, that we include the New Haven Railroad and absorb part of its operating losses until the inclusion is consummated, or for three years, whichever is earlier. The ICC has approved an agreement for our purchase of the New Haven, but this is being challenged in litigation, principally by bondholders of the New Haven.

The Commission also has approved an agreement that Penn Central lend the New Haven up to $25 million over a three-year period unless inclusion is accomplished sooner. On February 15, 1968, the New Haven received $5 million under this agreement, which is secured by trustees' certificates and which will be part of the settlement when the New Haven is sold to Penn Central.

The Supreme Court's decision of January 15, 1968, which authorized the Penn Central merger, also ordered the Norfolk & Western to include the Erie-Lackawanna, Delaware & Hudson and Boston & Maine railroads in its system on terms prescribed by the ICC. The Erie-Lackawanna has accepted these terms, and its inclusion is scheduled for about April 1. The Commission has directed that inclusion of the Delaware & Hudson and Boston and Maine Railroads, if approved by their stockholders, should be accomplished by May 31, 1968.

We are continuing to oppose the merger proposal of the Norfolk & Western and the Chesapeake & Ohio systems, and have testified on various aspects of the case in hearings before the ICC.

Unit trains from mine to consumer are reviving growth of coal industry.

THE PENN CENTRAL MERGER STORY

Merger of the Pennsylvania and New York Central railroads was first proposed in 1957, but it was not until November 8, 1961, that the two companies announced their intention to file a merger application with the Interstate Commerce Commission. Thus began a dramatic struggle that lasted more than six years, until consummation of the merger on February 1, 1968.

Formal application was filed with the ICC on March 9, 1962, and in May of the same year stockholders of the two companies voted overwhelmingly in favor of the merger.

ICC hearings in the Penn Central case, which opened on August 20, 1962, and closed September 16, 1964, were the most exhaustive in the Commission's history. They ended after 129 days of hearings in 18 cities. The record of testimony fills some 40,000 pages—the largest single record that had ever been submitted to the Commission. A total of 461 witnesses offered 290 prepared statements and 347 exhibits. Some 337 attorneys, representing 276 parties of interest, made appearances on behalf of railroads, shippers, municipalities, state and Federal agencies, civic and business groups and labor organizations.

As the initial step in restructuring the Eastern railroads, the ICC granted control of the Baltimore & Ohio to the Chesapeake & Ohio in December, 1962. It also approved the Norfolk & Western — Nickel Plate—Wabash merger in July, 1964, subject to Pennsylvania divestiture of its N&W and Wabash holdings. The Pennsylvania agreed to these conditions, and the N&W merger became effective in October, 1964.

On October 1, 1963, Stuart T. Saunders succeeded James M. Symes as Chairman of the Pennsylvania. With Alfred E. Perlman, President of the Central, he initiated a broad and intensified program to remove obstacles to the merger.

The most formidable barriers at that stage were the opposition of organized labor, the Federal Department of Justice, and certain states, cities and localities in the territory of the proposed Penn Central.

Labor ceased its active opposition after agreements were negotiated which provided that no employes would lose their jobs as a result of the merger, but positions would be discontinued only as they were vacated by normal attrition and turnover of employment.

The Justice Department at the outset strongly expressed its "unqualified opposition" to the merger but eventually recognized the necessity of the merger in the public interest. In the first round of litigation in the courts, the Department stated its position as one of "neither support nor opposition." In the final hearing before the Supreme Court on November 6, 1967, the Justice Department joined the ICC in urging prompt consummation. The two Governmental bodies declared that "further delay of the merger would be contrary to the public interest."

The objections of certain states and many cities and communities were changed to support, and at the time of the final hearings virtually all of the thousands of localities in Penn Central territory were in favor of the merger.

On March 29, 1965, ICC examiners issued a report favoring the Penn Central merger and recommending inclusion of the New Haven Railroad. The Pennsylvania and Central reached an understanding in principle with trustees of the New Haven for the purchase of that railroad, contingent on the merger of the Pennsylvania and the New York Central. This development gave additional emphasis to the public interest aspects of the merger.

Following oral argument in the Penn Central case which opened on October 20, 1965, the Interstate Commerce Commission gave unanimous approval to the Penn Central merger on April 27, 1966. The Commission attached conditions designed to protect weaker lines from the effects of the merger.

The contest in the courts began in September, 1966, when other railroads sought to delay the Penn Central merger. After a three-judge Federal court of the Southern District of New York refused to grant an injunction, a stay was ordered by the United States Supreme Court, which heard argument in early January, 1967. The Supreme Court, in a 5-4 decision, reversed the lower court and remanded the case with instructions that it be returned to the ICC for further proceedings to determine specifically the protective provisions for the E-L, D&H and B&M and related issues that had been raised by them and other railroads. Expeditious handling of the case was ordered by the Court.

On June 12, 1967, the ICC issued a supplemental report revising protective conditions for the E-L, D&H and B&M and again authorized consummation of the Penn Central merger. Simultaneously, the Commission also directed inclusion of E-L, D&H and B&M into the Norfolk & Western system. These decisions were challenged in the courts, but on October 19, a three-judge Federal court of the Southern District of New York refused to enjoin the merger and affirmed the ICC rulings in both cases. This decision was appealed to the Supreme Court by opponents of the merger.

On January 15, 1968, the Supreme Court announced a unanimous decision upholding the Penn Central merger. This cleared the way for the merger to become effective at 12:01 a.m. on February 1. At the same time, the Court upheld the ICC order for inclusion of the E-L, D&H and B&M in the N&W system.

On November 21, 1967, the ICC approved inclusion of the New Haven in the Penn Central on terms agreed to by the Penn Central and New Haven trustees. The Commission required the Penn Central to share the operating losses of the New Haven and approved an interim loan of up to $25 million by Penn Central to the New Haven over a three-year period, after our merger.

The N&W on February 12, 1968, stated that it would move promptly to include the E-L in its system. A few days later, the ICC set May 31, 1968, as the deadline for inclusion of the D&H and B&M railroads in the N&W system.

Special-purpose equipment for chemical and forest products serves varied needs of Penn Central shippers.

CONSOLIDATED FINANCIAL STATEMENTS

Earnings

	Year Ended December 31	1967	1966
Current Earnings			
Income	Transportation revenues	**$1,758,997,211**	$1,836,197,955
	Real estate and other sales and revenues	**264,023,071**	155,026,057
	Dividends, interest and other income	**51,256,620**	51,214,771
	Total Income	**2,074,276,902**	2,042,438,783
Costs and Expenses	Wages, salaries and other employment costs	**991,810,038**	979,340,309
	Cost of properties sold, materials used, other charges	**698,178,052**	619,718,566
	Depreciation, amortization and depletion	**137,949,859**	133,171,891
	Federal income taxes	**4,077,667**	7,157,887
	State, local and other taxes	**64,817,371**	54,630,097
	Interest and debt expense	**94,509,037**	86,976,706
	Minority interest in income of subsidiaries	**11,501,538**	14,153,749
	Total Costs and Expenses	**2,002,843,562**	1,895,149,205
Earnings	From ordinary operations	**71,433,340**	147,289,578
	Extraordinary charge for costs and losses incurred upon merger	**275,421,985**	—
Net Earnings (Loss)	For the year	**(203,988,645)**	147,289,578
Earnings Retained	From prior years	**1,891,347,891**	1,797,704,979
	Total Available	**1,687,359,246**	1,944,994,557
	Dividends	**55,051,906**	53,646,666
	Total Earnings Retained	**1,632,307,340**	1,891,347,891
Earnings Per Share	From ordinary operations	**$3.10**	$6.44
	For extraordinary charge	**(11.96)**	—
	Net earnings (loss)	**(8.86)**	6.44

See notes to financial statements, pages 29, 30 and 32

Balance Sheet

	December 31	1967	1966
Assets			
Current	Cash and temporary investments	**$ 139,975,028**	$ 192,266,509
	Accounts receivable and unbilled revenue	**248,306,646**	210,668,426
	Materials, supplies and other	**126,707,403**	130,665,993
	Total Current Assets	**514,989,077**	533,600,928
Investments	Securities owned and advances	**266,938,876**	275,880,261
	Unconsolidated (and 50% owned) subsidiaries	**87,568,072**	82,864,203
	Total investments	**354,506,948**	358,744,464
Properties	Land, structures and equipment	**7,160,320,018**	7,098,769,781
	Less: allowance for amortization, depreciation and losses upon merger	**1,929,869,615**	1,831,662,110
	Total Properties—Net	**5,230,450,403**	5,267,107,671
Other	Deferred charges and sundry assets	**47,152,099**	43,324,912
	Investment in consolidated subsidiaries in excess of net assets	**117,217,410**	117,017,480
	Total Other Assets	**164,369,509**	160,342,392
	Total Assets	**6,264,315,937**	6,319,795,455
Liabilities			
Current	Accounts, wages and other	**424,393,031**	376,457,186
Long Term Debt	Due within one year	**120,645,169**	129,059,347
	Due after one year	**2,007,946,045**	1,993,142,619
	Total Long Term Debt	**2,128,591,214**	2,122,201,966
Other	Estimated liabilities incurred upon merger	**143,549,672**	—
	Allowance for casualty and other claims	**54,607,125**	52,608,857
	Deferred credits and other liabilities	**200,999,802**	214,002,794
	Minority interest in subsidiaries	**261,044,813**	246,895,676
	Excess of net assets of consolidated subsidiaries over investment	**155,373,249**	156,248,835
	Total Other	**815,574,661**	669,756,162
Shareholders' Equity	Capital stock—$10 par value (giving effect to merger)	**230,162,740**	228,838,680
	Capital surplus	**1,033,286,951**	1,031,193,570
	Earnings retained	**1,632,307,340**	1,891,347,891
	Total Shareholders' Equity	**2,895,757,031**	3,151,380,141
	Total Liabilities and Shareholders' Equity	**6,264,315,937**	6,319,795,455

See notes to financial statements, pages 29, 30 and 32

Penn Central is an integral part of automobile production lines.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

BASIS OF CONSOLIDATION AND CHANGE IN ACCOUNTING POLICY

On February 1, 1968 The New York Central Railroad Co. was merged into The Pennsylvania Railroad Co. and the corporate name changed to Pennsylvania New York Central Transportation Company. For accounting purposes the merger is treated as a "pooling of interests" and the financial statements for years 1967 and 1966 are presented on a consolidated basis that includes:

(1) Pennsylvania New York Central Transportation Company, parent.

(2) Subsidiaries controlled by the Pennsylvania New York Central Transportation Company or its subsidiaries through ownership of more than 50% of the voting stock, except that companies, control of which is expected to be temporary, are not consolidated. Excluded are the Wabash Railroad Company, the divestment of which is arranged as ordered by the Interstate Commerce Commission, and the Lehigh Valley Railroad Company, negotiation for whose inclusion in another railroad system has been ordered by the Commission in the Penn Central merger case. (Companies owned 50% or less are carried as an investment at cost or less.)

The consolidated financial statements reflect limited change in accounting policy necessary to effect substantially equivalent practices for each of the merging companies. Financial condition and results for 1966 are restated to conform with the changes effected in 1967. The changes in accounting policy do not have a material effect upon financial condition or results.

The separately determined results for the Pennsylvania Railroad and its consolidated subsidiaries, following accounting policies and practices employed prior to merger, show gross income of $1,163,197,264 in 1967 and $1,139,976,008 in 1966, earnings from ordinary operations of $60,344,240 in 1967 and $90,292,727 in 1966, and an extraordinary charge of $149,525,000 in 1967 for the costs and losses incurred upon merger; The New York Central Railroad and its consolidated subsidiaries show gross income of $819,980,411 in 1967 and $817,977,908 in 1966, earnings from ordinary operations of $10,995,654 in 1967 and $60,303,348 in 1966, and extraordinary charges of $125,896,985 for the costs and losses incurred upon merger, and of $3,148,391 for losses incident to sale of part of its investment in a consolidated subsidiary.

Financial statements for The Pennsylvania Railroad Company and The New York Central Railroad Company, together with condensed financial statements for selected subsidiaries, are available in a supplement to the annual report. As a result of intercompany dividends and other transactions, these statements should be considered separately and may not be combined without effecting appropriate elimination.

PENSION COSTS

Pension plans supplemental to benefits available under Federal retirement acts are provided for substantially all management employes together with certain members of railroad unions who, by December 31, 1960 or subsequent qualifying date, had elected to participate. The total pension expense for year 1967 was $2,376,180 and for year 1966 was $1,865,895. The companies' policy is to fund pension cost accrued and substantially all of the plans are fully funded at December 31, 1967.

FEDERAL INCOME TAXES

Federal income taxes reported in the Statement of Earnings include, net after adjustments, *Cr.* $417,594 for 1967 and $901,958 for 1966 representing taxes estimated to be payable on account of subsidiary and lessor companies for which separate tax returns have been or are to be filed. In addition, Federal income taxes include deferred taxes of $4,495,261 in 1967 and $6,162,972 in 1966 charged to earnings by consolidated subsidiary companies either not in the affiliated groups (for tax purposes) or as to which tax effect accounting policy had been adopted in prior years and is continued.

Deferred Credits and Other Liabilities reported in the Balance Sheet include amounts accumulated as deferred taxes of $57,454,033 as of December 31, 1967 and $53,064,064 as of December 31, 1966 provided in the accounts of certain consolidated subsidiary companies. Of these amounts, charges of $3,797,245 for 1967 and $4,420,757 for 1966 resulting in cumulative deferred taxes of $50,820,178 as of December 31, 1967 and $47,022,933 as of December 31, 1966 reflect deferred taxes in the accounts of transportation subsidiaries and, to this extent, differ from amounts of earnings and liabilities reported to the Interstate Commerce Commission whose regulations do not provide for deferred tax accounting.

The consolidated Federal income tax returns filed by the Pennsylvania Railroad affiliated group for the years prior to 1954 have been reviewed by the Internal Revenue Service and all tax liabilities have been settled. For the year 1954 the Internal Revenue Service has proposed additional taxes, based primarily upon its assertion that deductions should be spread to later years to a degree not consistent with the approved treatment of similar items in prior years. The company and its subsidiaries are protesting the proposed deficiency before the Audit Division of the Service; counsel is unable to determine the amount of liability, if any, which may ultimately accrue. The consolidated returns for the years 1955 through 1964 are under examination by the field agents of the Internal Revenue Service. While certain differences are under discussion, no deficiency for these years has been proposed.

The consolidated Federal income tax returns filed by the New York Central affiliated group for the years prior to 1956 have been reviewed by the Internal Revenue Service and all tax liabilities have been settled. The tax returns for subsequent years, all of which indicated no tax liability, are subject to review by the Internal Revenue Service; however, the statute of limitations bars any deficiency for the years prior to 1964, other than 1962.

Because of net operating losses and net operating loss carryovers, no Federal income taxes are estimated to be payable on account of 1967 or 1966 income of the companies included in the Pennsylvania Railroad affiliated group or of the companies included in the New York Central affiliated group and no material reduction of taxes otherwise payable for these years was effected by use of accelerated depreciation, guide line lives or investment credit for such years.

Notes continued

EXTRAORDINARY ITEM

The Penn Central merger results in duplication or obsolescence of certain railroad properties, equipment, materials and supplies, and the requirement to rehire certain otherwise surplus furloughed employes, all of which are estimated to represent $275,421,985 in costs and losses. An extraordinary charge for these items has been provided as a reduction of earnings in 1967. The effect on the balance sheet, at December 31, 1967 is

Adjustment of Assets	
Obsolescence of materials and supplies	$ 6,013,000
Impairment in value of properties	125,859,313
	131,872,313
Provision for Liabilities	
Impairment in value of leased property	385,461
Cost to demolish obsolete properties	26,236,211
Cost of recalled employes	116,928,000
Liabilities incurred upon merger	143,549,672
Total costs and losses incurred upon merger	$275,421,985

INVESTMENTS

All investments are represented at cost or less.

Securities owned and advances:

Norfolk & Western Railway Company

On October 16, 1964 the Norfolk & Western-Nickel Plate-Wabash Unification Plan became effective pursuant to order of the Interstate Commerce Commission. As ordered by the Commission, voting rights of the Norfolk & Western holdings are placed with Trustees under Voting Trust Agreements until the required divestiture of such holdings is completed within 10 years of date of N. & W. unification plan.

Under an exchange agreement with N. & W. approved in April 1966 by the Interstate Commerce Commission, 800,000 of its common shares are to be delivered in stipulated installments to N. & W. in exchange for $104,000,000 principal amount of N. & W. 4⅝% debentures, convertible into N. & W. stock by any holder other than Penn Central or its affiliates. During 1967, 160,000 of such shares were exchanged for $20,800,000 of the debentures and in 1966, 80,000 shares were exchanged for $10,400,000 debentures. The total consideration of $104,000,000 received or receivable under the exchange agreement was recorded as an investment; at December 31, 1967, $23,960,000 of the debentures were sold. The estimated profit resulting under the exchange agreement is being recognized as income ratably over the term of the agreement. Of the total profit, $9,758,584 is included in earnings for 1967 and $9,862,238 for 1966. At December 31, 1967 there is $60,793,750 of profit deferred to later periods.

Of the total investment in N. & W., 1,542,784 shares of common stock are carried at cost of $40,484,248 at December 31, 1967. Dividends received in 1967 on N. & W. common stock (including the shares held for exchange) amount to $13,336,704 and in 1966 were $15,068,096.

Of the total of N. & W. shares held at December 31, 1967, there are pledged 1,451,763 shares of common stock with Trustee of collateral trust indentures of Pennsylvania Company and 516,308 shares of common stock are escrowed to meet redemption privilege of Pennsylvania Company preferred stock.

Unconsolidated (and 50% owned) subsidiaries:

Wabash Railroad Company

Investment in Wabash is carried at $8,273,995 at December 31, 1967 representing 595,255 shares of common stock and $13,226,400 par value 4½% cumulative preferred stock. Dividends on common stock received from Wabash were $9,166,927 in 1967 and $11,458,659 in 1966.

The Wabash properties were leased to the Norfolk & Western Ry., effective October, 1964 under a rental arrangement that provides for all related expenses, a fixed rental and additional rental equated to dividends declared on N. & W. common stock. An agreement also provides for exchange of all the Wabash common stock for 671,692 shares of N. & W. common stock after 6 years from date of lease. The N. & W. common shares to be acquired through this exchange are subject to the voting restriction and divestiture requirements of the I.C.C. order authorizing the lease.

At December 31, 1967 there are pledged 28,028 shares of preferred stock with Trustee of a collateral trust indenture of Pennsylvania Company.

Lehigh Valley Railroad Company

Investment in Lehigh Valley is carried at $27,163,995 at December 31, 1967 representing 1,475,579 shares of capital stock and $9,316,500 par value of bonds. The book value, as reflected in financial reports of Lehigh Valley, indicates $79,041,823 equity attributable to Penn Central's 97.3% stock interest. Lehigh Valley reported deficits of $3,737,516 in 1967 and $2,868,618 in 1966.

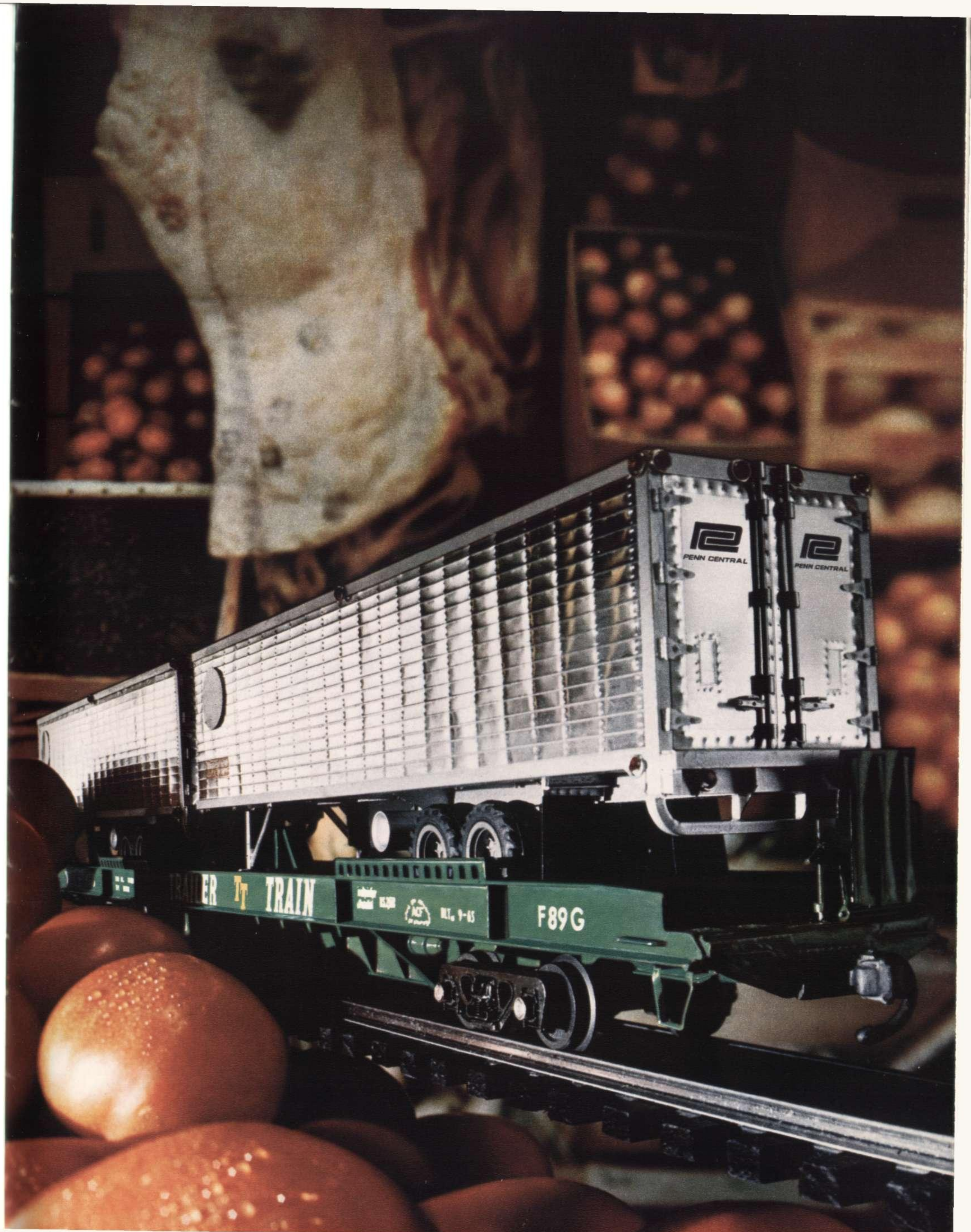
Companies 50% Owned

Investment in 50% owned companies, representing stock, bonds and advances are carried at cost (or less) of $42,318,257 at December 31, 1967 and $41,756,532 at December 31, 1966. The net assets attributable to these holdings, as reported by the respective companies, exceeded the carrying value by $6,479,603 at December 31, 1967 and by $6,607,330 at December 31, 1966.

PROPERTIES

Properties are represented principally at cost or less; they include land and improvements held for resale.

	1967	1966
Transportation properties	$6,706,899,852	$6,642,432,233
Less: Accumulated depreciation, amortization and losses upon merger	1,850,049,504	1,756,909,924
Net transportation properties	4,856,850,348	4,885,522,309
Other properties	453,420,166	456,337,548
Less: Accumulated depreciation, amortization and depletion	79,820,111	74,752,186
Net other properties	373,600,055	381,585,362
TOTAL PROPERTIES—NET	5,230,450,403	5,267,107,671



Penn Central piggyback trailers serve America's food industry.

Notes continued

LONG TERM DEBT

	1967	1966
Due in one year		
Transportation companies	$ 103,797,823	$ 110,078,021
Other companies	16,847,346	18,981,326
Total	120,645,169	129,059,347
Due after one year		
Transportation companies	1,792,048,827	1,768,847,775
Other companies	215,897,218	224,294,844
Total	2,007,946,045	1,993,142,619
TOTAL LONG TERM DEBT	$2,128,591,214	$2,122,201,966

Long Term Leases

The System has additional obligations under long term rail transportation equipment leases. The remaining rentals payable under these leases, including amortization of the lessors' costs of the equipment, amount to $307,000,000. Rentals for equipment acquired under these lease arrangements amounted to $27,200,000 for 1967 and will be approximately $31,000,000 for 1968.

Pledges

Investments, including investment in consolidated subsidiaries, with a cost of $263,715,425 are pledged under indentures or agreements.

CONTINGENT LIABILITIES

Commitment to purchase New Haven Railroad

The Interstate Commerce Commission, as a condition of Penn Central's merger, requires that the New York, New Haven and Hartford Railroad be included in the merged system. The I.C.C. in their decision of November 16, 1967 upheld, with certain modifications, an agreement dated April 21, 1966, as amended October 4, 1966, which provides for the purchase by Penn Central of substantially all of New Haven's properties and investments.

The purchase agreement requires the following payments and assumptions of debt and other obligations by Penn Central, subject to certain adjustments:

1. Payment of 950,000 shares in Penn Central Capital Stock.
2. Payment of $8 million in cash.
3. Payment of $23 million in Penn Central bonds.
4. Assumption of New Haven equipment obligations of approximately $28 million, as of December 31, 1963.
5. Assumption of a mortgage lien not in excess of $3.2 million, the principal amount of bonds, to be issued under a proposed Boston and Providence Railroad Corp. plan of reorganization.
6. Assumption of pension and labor protection costs for New Haven employes.

The modifications to the agreement require Penn Central to increase the purchase price by a maximum of $5.5 million per year, beginning with the effective date of the Penn Central merger, limited to a 3-year period. Penn Central is also required to make cash loans to the New Haven up to a maximum of $25 million, at prime interest rates. On Feb. 15, 1968 Penn Central advanced $5 million to the New Haven under the modified agreement.

The purchase agreement is being challenged in litigation, principally on behalf of bond holders of the New Haven.

Other Contingent Liabilities

The Penn Central consolidated group has contingent liabilities (not included as liabilities in the Balance Sheet) aggregating $265,038,830 on December 31, 1967, in respect to the principal of obligations issued by affiliated companies; $245,607,222 of these contingent obligations have been entered into jointly or jointly and severally with other companies.

In addition there are other contingent liabilities indeterminate in amount, in respect to taxes, personal injuries, property damage, purchase agreements and other matters.

CAPITAL STOCK

The Penn Central merger effective February 1, 1968 results in exchange of 1 share of Central stock for 1.3 shares of Pennsylvania stock. The balance sheet at December 31, 1967 gives effect to the exchange of 6,925,404 shares of Central stock, par $1 per share for 9,003,025 shares of Pennsylvania stock, par $10 per share. The excess of par value of Pennsylvania stock issued over par value of Central stock exchanged, $83,104,846 ($82,730,668 for 1966) is charged against the combined capital surplus of Penn Central.

The stock option plans authorized by stockholders for officers and key employes result in the following transactions and conditions. For comparative purposes the Central option plan has been converted to equivalent Pennsylvania shares.

	Stock Option Plans		N.Y.C.
For 1967	Restricted	Qualified	Options
Number of shares			
Outstanding options— beginning of year	177,240	20,950	89,380
Options granted	—	—	—
Options exercised	82,920	8,950	32,600
Options lapsed	1,200	8,000	9,881
At December 31, 1967—			
Outstanding options	93,120	4,000	46,899
Available but unoptioned	*	660,000	**
Options exercisable	44,520	2,250	17,794

*Expired May 7, 1967
**Expired January 31, 1968

During 1967 options granted under the Restricted Plan were exercised at prices of $21.75 and $24.50 per share for a total of $1,973,790, those under the Qualified Plan were exercised at prices of $28.00 and $46.25, for a total of $396,600, and those under the N.Y.C. option plan were exercised at prices ranging from $12.50 to $28.08 per share for a total of $603,611. Options exercisable after December 31, 1967 are at prices ranging from $12.50 to $62.94.

PENN CENTRAL